Economic Outlook

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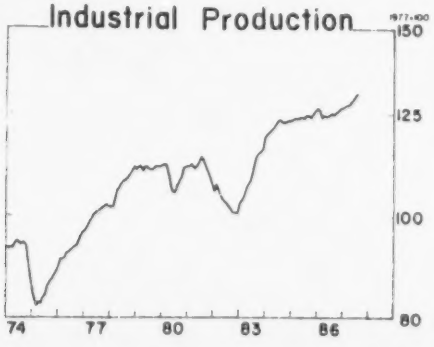
After having suffered a virtual recession between 1984 and 1986, the U.S. industrial sector has now regained its strength. This recovery can be clearly seen in the following chart. The industrial production index grew at an annual rate of 5.1% since last September, compared with a paltry annual increase of 1% in the previous two years. The 40% depreciation of the dollar since early 1985, which significantly boosted U.S. industries' competitiveness, was mainly responsible for the turnaround. Domestic markets recovered, and inroads were also made in foreign markets. The volume of manufactured goods exports has increased by 12% during the past year. Reflecting the increases in output, factory employment has also risen. In contrast to the massive layoffs and falling factory employment in 1985 and 1986, factory payrolls have increased by 131,000 since the beginning of this year.



Partly as a result of failing to appreciate the revival of the industrial sector, many analysts were surprised by the strength of the economy in the first half of this year. Most forecasts underestimated actual growth in both of the last two quarters. For the current quarter the consensus forecast for real GNP growth is around 2 1/2%. Recently released economic statistics, however, seem to suggest that the consensus forecast may once again undershoot the target. Consumer spending is strong, with retail sales in the July-August period 1.9% higher than in the second quarter. Business capital spending is also strong, as reflected in continued increases in capital goods orders and shipments. Industrial production in July and August was 1.7% higher than the second quarter average in spite of a sharp cutback in auto production. Total man-hours worked in the private nonagricultural sector increased at an annual rate of 3.3% in the July-August period, compared to an increase of 2.0% in the second quarter when real GNP grew by 2.5%. Based on such statistics, we forecast that real GNP growth will be 3% or better in the current quarter.

Inflation fears seem to have subsided somewhat in recent months. Consumer price inflation, after hovering around an annual rate of 5 1/2% earlier this year, has slowed to 4% for the time being. However, inflationary pressures are intensifying beneath the surface. Accelerating industrial production growth will continue to exert upward pressure on commodity prices. Perhaps

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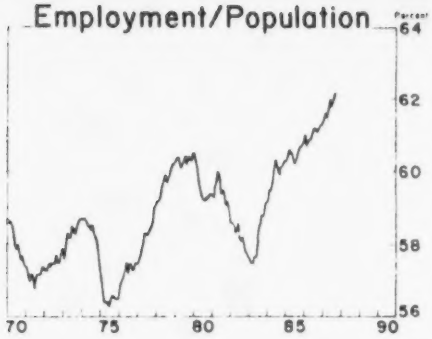

more important, the labor market has tightened significantly. As the above chart shows, the employment/population ratio, a measure considered to be an important gauge of labor market tightness, is now at an all-time high of 62%. The extremely low number of initial unemployment insurance claims, the long weekly work hours, and the high help-wanted advertising index all point to a further tightening of the labor market in coming months. Although wage increases have remained moderate up to now, an acceleration seems inevitable.

Victor Kung

Real GNP

(Percent Contribution to Real GNP Growth; Annual Rates)	Actual 1986 III	1986 IV	1987 I	1987 II	Forecast 1987 III	1987 IV	1988 I	1988 II	Actual 1985-1986	Forecast 1986-1987	Forecast 1987-1988
Consumer Spending	4.7	0.3	-0.5	1.2	3.0	0.4	1.3	1.3	2.7	1.3	1.4
Business Investment	-0.4	0.6	-1.9	1.3	0.6	0.6	0.6	0.6	-0.3	-0.1	0.6
Residential Investment	0.5	0.1	-0.4	-0.2	-0.1	-0.2	-0.1	-0.1	0.6	0.0	-0.1
Change in Inventories*	-3.1	-0.1	4.4	-1.6	-2.0	0.9	0.1	0.2	0.0	0.1	-0.3
Net Exports	-1.6	1.1	1.8	0.3	0.9	1.3	0.8	0.8	-1.0	0.5	0.8
Government Purchases*	1.3	-0.5	1.0	1.5	0.9	0.7	0.5	0.6	0.9	0.9	0.8
Real GNP	1.4	1.5	4.4	2.5	3.3	3.7	3.2	3.4	2.9	2.7	3.2

Quarterly Economic Indicators

(Percent Changes at Annual Rates)	Actual 1986 III	1986 IV	1987 I	1987 II	Forecast 1987 III	1987 IV	1988 I	1988 II	Actual 1985-1986	Forecast 1986-1987	Forecast 1987-1988
Nominal GNP	5.3	2.1	8.6	6.3	7.4	8.3	8.2	8.9	5.6	6.0	8.3
GNP Deflator	3.6	0.7	4.2	3.5	4.1	4.5	4.9	5.4	2.6	3.2	4.9
Corporate Profits After Tax#	0.4	-0.3	6.7	9.9	5.3	6.3	12.5	10.1	-1.0	7.3	9.5

Monthly Economic Indicators

	Recent Data Jun.	Jul.	Aug.	Actual 1986	Forecast 1987	Forecast 1988
Consumer Price Index** (%)	0.4	0.2	n.a.	1.1	5.0	6.1
Industrial Production (%)	0.7	0.8	0.3	1.0	3.6	4.3
Retail Sales (%)	1.2	0.5	1.3	5.5	3.9	4.2
Auto Sales (million units, a.r.)	10.0	10.5	12.4	11.5	10.3	10.0
Housing Starts (million units, a.r.)	1.59	1.61	1.58	1.81	1.65	1.61
Unemployment Rate (%)	6.1	6.0	6.0	7.0	6.2	5.6
Merchandise Trade Deficit ($ bn., a.r.)	-188.5	-197.7	n.a.	-156.2	-155.0	-135.0

*Adjusted for CCC purchases. **Annual percent changes are December to December.
#Quarterly data are year-over-year percent changes.
a.r.=annual rate F=Forecast